# Session 1

Zero - home
Nine - accounts.



- Arthashastra by Kautilya - 3rd Century BC
- Modern day understanding : Adam Smith - An Inquiry into the Nature & Causes of the Wealth of Nations in 1776
- David Ricardo - On the principles of Political Economy & Taxation in 1817
  - Classical School of Economics : Proponents of free market economy / laissez faire
- Alfred Marshall → Economics ; Principles of Economics 1890
  Differentiated it from Political Economy as the subject was earlier known - economics is an independent social science with different issues from those of politics
- John Maynard Keynes whose work ultimately led to development of two streams : Micro & Macro.
- Further expansion of the field into development economics, game theory & network theory & many more economists emerged in the 20th Century.
- Many more schools of economics like Keynesian, neo-classical, Chicago, Austrian etc.

- Microeconomics - Deals with the behaviour of individual economic units like consumers, resource owners, producers, business firms etc
  - Explains how & why these units make economic decisions
    E.g. consumers making purchasing decisions based on prices & income
    Firms decision regarding how many workers to hire etc.
  - Also looks at how individual economic units interact to form larger units like markets and industries.

'You can't always get what you want' < Unlimited wants, limited resources

- There are limits to what one can have or do - Mic's of micro is about limits - limited income, limited budgets and technical know-how that firms can use to produce things and limited no. of hours that markets can allocate to work or leisure.

- However micro suggests ways to make the most of these limits → Allocation of scarce resources

E.g. how firms can best allocate limited financial resources to hiring additional workers v/s buying new machinery, or producing one product v/s another.

Thus it is very important in corporate decision making

E.g. Tayota, Tesla - high import tax on electric vehicles in India

What to produce, How to produce, For whom to produce

Key economic questions

which microeconomics as a tool, can help to answer.

- Thinking like an economist - 10 principles (how to approach & understand economics both micro & macro)

1. Intuitively
2. Graphically
3. Mathematically

- Economy: group of people dealing with one another as they go about their lives; Behaviour of economy reflects the behaviour of individuals and what decisions they make.

(1) People face trade-off. - No free lunch.

To get something we like we usually have to give up something else that we also like.

- Classic trade-off: e.g. 'guns & butter'

(2) The cost of something is what you give up to get it. (3)
"opportunity costs"

E.g. Costs of going to college
↓
tuition, but also your time which could have been spent working and earning money

(3) Rational people think at the margin/edge.
↓
People systematically and purposefully do the best they can to achieve their objectives, given the available opportunities

E.g. At dinner, asking yourself 'should we eat more' or eat more is not usually the question we ask, but should I take an extra slot of bowl of paneer/chicken!

- Making marginal decisions i.e. decisions at the edge of what you are doing E.g. Netflix.
- Diamond water paradox: Why is water so cheap and diamonds expensive?
  water → plentiful
  diamonds → rare
  Marginal benefit of an extra diamond >>>> Marginal benefit of an extra cup of water.

(4) People respond to incentives - something that induces a person to act, such as when you give them a punishment or reward.

E.g. when price of a good rises; deadweight loss and direct v/s indirect effects via perverse incentives.

- Next 3 principles focus on how people interact with each other.

(5) Trade can make everyone better off.
↓
Allows people and countries to specialise in what they do best and to enjoy a greater variety of goods and services at lower costs.

(6) Markets are usually a good way to organize economic activity.

(4)

Central planning v/s Market economy

Govt decides who, what how & for whom to produce

Decision is based on the decisions of millions of firms & households.
- Prices & self interest guides their decision

- Invisible hand : Adam Smith.
  E.g. Uber.

(7) Governments can sometimes improve market outcomes

(i) Why do we need the govt? The invisible hand works only if the govt. enforces the rules and maintains the institutions that are key to a market economy
- Property rights : Ability of an individual to own and exercise control over scarce resources.

(ii) Although invisible hand is powerful, it is not ~~all-powerful~~ omnipotent
- Efficiency : Enlarging the economic pie
- Equality : changing how the pie is allocated.

Market failures - inability of the market to allocate resources efficiently
- Externalities
- Market power

→ The invisible hand does not ensure that everyone has sufficient food, decent clothing and adequate healthcare.

How the economy works as a whole → Decisions + Interactions (5)
and this is where we get into the realm of Macro Econ.

(8) A country's standard of living depends on its ability to produce goods and services.

US - 60,000 $ 2016 → Average income
Ind - 5,000 $ 2016 - " "

What explains these large differences in living standards across countries and time?

- Productivity : qty of goods and services produced from each unit of labour input

Raising productivity by ensuring that workers are well educated, have the tools they need to produce goods and services, and have access to the best available technology.

(9) Prices rises when the govt prints too much money

1921 Germany - newspaper - 0.30 marks
1922 - 70,000,000 marks

Inflation - an increase in the overall level of prices in the economy

Why does inflation happen?
Most cases, because of growth in the qty of money → value of money falls (LR)

(10) Society faces a short run trade-off b/w inflation and unemployment.
(SR)

step1 ↑ amount of money → ↑ spending → ↑ demand for goods and services
step2 ↑ demand → 1. ↑ hire more workers to produce a large qty of goods
2. ↑ in prices
↑ hiring → ↓ unemployment.

Economics is concerned with the explanations of observed behavioural phenomena. For eg: Why firms hire workers when prices of raw material changes?

and these explanations are based on theories, which are developed to explain observed phenomena in terms of a set of basic rules & assumptions.

So, For eg, when we look at a firm, we can explain how the firm chooses the amount of L & K based on a theory with the possible assumption that firms try to minimize their profit.

How do we study this?

We try to understand certain economic phenomena by using simple models (diagrams & eqns) which are based on certain theories that has certain rules and assumptions.

E.g. how firms choose say the amount of labour, and hardware, ~~based on~~ but there could be a theory which assumes that this decision is based on firms trying to maximize their profits.

All models explaining real phenomena are based on assumptions. As you relax these assumptions, you may see that the outcome/results of that model are not holding in the real world. Why do we studies these models then at all?

Geog Box "All models are wrong but some are useful".
Famous Statistician

(7) ~~Whole most of the~~ Most of the study of economics is based on explaining why things are how they are - Positive economics - description

However, this is very distinctive from what we call normative economics, which explain how things ought to be. Goes into the realm of value judgement. - prescriptive

Eg. ↓↑ p for essential needs, leads to ↑ in PD - +ve

Price should be decreased for essential needs - normative.

Economists
- scientists (explain phenomena) - Claim about how the world works
- policy advisors (help improve things) - claim about how the world should be.